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# Article

Corporate & Commercial

## Vendor Safety Nets

### Big transactions come with big risk – our M&A team has put together a quick guide to limiting Vendor liability in large transactions

**By Brett Thorneycroft & Navar Amici**

A Purchaser looking to acquire shares in a company[1] carries a significant burden. A wise Purchaser is naturally wary and will conduct thorough due diligence to uncover the target's liabilities and any hidden skeletons that may impact its profitability and viability in the future. But, this natural inclination towards cynicism will often lead to heavily one-sided sale contracts, with excessive indemnities and warranties required of the Vendor in favour of the Purchaser.

If not given due consideration, the nature and extent of these warranties and indemnities can have significant consequences for the Vendor. It is all too common for sale agreements to be silent on the consequences of minor breaches of the Vendor's warranties. This can lead to the Vendor incurring unnecessary and often wholly disproportionate expenses in negotiating an appropriate remedy with the Purchaser.

But there are solutions. A de-minimis clause can be incorporated into sale contracts to set a minimum monetary threshold for any warranty claims for compensation made by the Purchaser. A de-minimis clause will usually dictate that until that prescribed threshold is reached, the Purchaser is barred from making a claim to recover damages from the seller. In effect, the de-minimis clause allows the Vendor to avoid dealing with relatively minor disputes and the time and costs they can quickly consume.

1 ie. acquire the entity or part thereof, rather than the assets of a business

Depending on the type of assets of the target business, or the level of risk tolerated by the Purchaser, often a de-minimis clause will be incorporated together with a 'basket clause'. These clauses establish a 'basket' in which claims for breaches of the warranties within the sales contract can be pooled together and added cumulatively. The basket clause will set a certain threshold or tipping point, at which the total pool of warranty claims will tip the basket, and each becomes claimable against the Vendor.

While de-minimis and basket clauses attempt to limit Vendor liability from the ground up, the same can be done in reverse. That is, a sales contract can include a liability cap clause, in which a limit can be set for the amount which can be claimed against the Vendor for any breaches of the terms of the agreement (including for breach of a warranty). A liability cap clause may operate in respect of a specific guarantee, warranty or indemnity, or may operate at a global level in respect of the entire sale agreement.[2] A carefully considered limitation clause can provide the parties with flexibility and control in respect of the allocation of risk, and opens up avenues for compromises that are not available through a boilerplate, broad-brush approach.

Lastly, Australian Courts have allowed parties to contract around statutes that seek to impose limitation

2 While not considered here, the complex but crucial topic of waranty insurance will be addressed in a future article.

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periods on bringing claims for breach of contract.[3] It is, therefore, possible for a Vendor to limit the time the Purchaser has to bring a claim against the Vendor for any breach of the sale agreement.

The apportionment of risk in commercial transactions is crucial. The joy of getting a deal across the line can quickly turn sour without clear limitations on liability and mechanisms for dealing with minor claims.

Suppose you need assistance understanding the process and liabilities associated with a significant transaction, or want to discuss a bespoke approach to the sale of your operating group or business. In that case, our team of experts are available to assist and ensure you get your business's sale right.


MORE INFO

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3 *Firstmac Fiduciary Services Pty Ltd v HSBC Bank of Australia Ltd [2012]* NSWSC 1122; *Commonwealth of Australia v Verwayan (1990)* 170 CLR 394 , 406 *Western Australia v Wardley Australia Ltd (1991)* 30 FCR 245 at 259.